Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
Seeks Comment on Certain of the Commission's Rules	)	
Relating to High-Cost Universal Service Support	)	

NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION INITIAL COMMENTS

NATIONAL TELECOMMUNICATIONS
COOPERATIVE ASSOCIATION

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SUMMARY

The National Telecommunications Cooperative Association (NTCA) urges the Federal-State Joint Board on Universal Service (Joint Board) to recommend that the Commission continue to use the embedded cost model to determine high-cost universal service support for rural carriers. In the enclosed white paper written by economist Dale Lehman, Professor Lehman demonstrates why embedded costs remain the most appropriate mechanism for determining the costs associated with providing service in rural telephone company service areas. (Attachment A). The paper stresses that cost minimization cannot be the primary focus of the Joint Board's and Commission's review of the modified embedded cost mechanism.

Professor Lehman's paper correctly points out that the Act's requirement of "sufficiency" and "predictability" make cost minimization important but only insofar as the goal of efficiency does not interfere with the goals of ensuring that consumers in rural areas receive "quality services" at "just, reasonable, and affordable" rates, and rates and services that are comparable to those provided in urban areas. Professor Lehman clearly shows that that a shift to a forward-looking standard is unlikely to achieve the goal of ensuring that consumers in rural areas receive "quality services" at "just, reasonable, and affordable" rates, and rates and services that are comparable to those provided in urban areas.

NTCA further recommends that given the likelihood that Congress will re-open the 1996 Telecommunications Act next year and the fact that there are several pending issues that have a key impact on universal service, the Joint Board should recommend that the Commission leave the current model in place and for the time being continue to use the current statutory definition of a rural telephone company in determining which companies qualify for rural high-cost universal support.

NTCA also urges the Joint Board to recommend the elimination of the identical support

rule, which allows competitive eligible telecommunications carriers (CETCs) to receive support based on the incumbent's costs. The Joint Board should recommend that CETC support be based on their own costs, not the incumbent's costs. NTCA further recommends that support for wireless CETCs should reflect the proper allocation of costs between the interstate and intrastate jurisdictions. While it may be inappropriate to use the same cost allocation rules for CETCs, the rules should provide for the proper allocation of CETC costs by means of estimates or proxy like mechanisms. Doing so would be an effective component to controlling the burgeoning size of the universal service fund as CETC support is driving the growth of the universal service fund (USF).

Lastly, NTCA believes that the time is ripe for the Commission to expand the list of contributors to include both facilities-based and non-facilities-based VoIP/IP-enabled service providers and all cable, wireless and satellite providers of broadband Internet access and other providers that connect to or benefit from connection to the public, regardless of the classification of the service as an information service, telecommunications service or private carriage service. The universe of "telecommunications carriers" and providers of telecommunications and the share of new providers' markets have expanded far beyond the boundaries that existed when the Commission first identified contributors to universal service. It is time for the Joint Board to recommend to the Commission that it expand the base of contributors to ensure contributions on an equitable and nondiscriminatory basis pursuant to Section 254(d).

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NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION
INITIAL COMMENTS

The National Telecommunications Cooperative Association (NTCA)[1] hereby files its initial comments in response to the Federal-State Joint Board on Universal Service (Joint Board) request for comment on issues recently referred to it by the Federal Communications Commission (Commission or FCC) relating to the high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan adopted in the Rural Task Force (RTF) Order.[2]

I. INTRODUCTION

The Commission has asked the Joint Board to consider whether a universal service support mechanism for rural carriers based on forward-looking economic cost estimates or embedded costs would most efficiently and effectively achieve the goals set forth in the Telecommunications Act of 1996.[3] Specifically, the Joint Boards seeks comment on whether the

[1] NTCA is the premier industry association representing rural telecommunications providers. Established in 1954 by eight rural telephone companies, today NTCA represents 560 rural rate-of-return regulated incumbent local exchange carriers (ILECs). All of its members are full service local exchange carriers, and many members provide wireless, cable, Internet, satellite and long distance services to their communities. Each member is a "rural telephone company" as defined in the Communications Act of 1934, as amended (Act). NTCA members are dedicated to providing competitive modern telecommunications services and ensuring the economic future of their rural communities.
[2] *See* FCC Public Notice, Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support, CC Docket No. 96-45, FCC 04J-2, (rel. August 16, 2004) (Public Notice).
[3] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act); *Referral Order*, FCC 04-125, ¶8. The 1996 Act amended the Communications Act of 1934 (Act). 47 U.S.C. §§ 151 *et seq.*

embedded cost universal service mechanism for rural carriers should be retained beyond the five years of the RTF plan; whether the definition of a "rural telephone company" should be modified for purposes of high-cost universal service support; whether support provided to competitive eligible telecommunications carriers (CETCs) should be based on their own costs; whether rural incumbent local exchange carrier (RILEC) support should be based on "study area average costs;" and whether the Commission should retain, repeal or modify rule 54.305, which requires a carrier that acquires an exchange or exchanges from an unaffiliated carrier to receive universal service support for those acquired exchanges at the same per-line support levels for which the exchanges were eligible for support prior to the acquisition.

II. THE EMBEDDED COST METHODOLOGY IS THE MOST APPROPRIATE METHOD FOR DETERMINING HIGH-COST SUPPORT FOR RURAL ILECs

The Joint Board seeks comment on whether forward looking cost estimates, embedded cost estimates, or some other method of determining costs should be used for determining rural high-cost universal service support.[4] The Board should recommend that the Commission retain the existing modified embedded cost mechanism for rural telephone companies. The embedded cost methodology is the most appropriate method for determining high-cost universal service support for rural carriers.[5]

Professor Dale Lehman in Attachment A to this filing explains why embedded costs remain the most appropriate mechanism for determining the costs associated with providing service in rural telephone company service areas.[6] Cost minimization cannot be the primary focus of the Board's review of the modified embedded cost mechanism. The Act's requirement of "sufficiency" and "predictability" make minimization important but only insofar as the goal of efficiency does not interfere with the goals of ensuring that consumers in rural areas receive

[4] Public Notice, ¶¶ 18-20.
[5] There may be a need to adjust the indexed cap but use of the mechanism is consistent with the goals of Section 254.
[6] The Role of Embedded Cost in Universal Service Funding, Dale Lehman (Attachment A).

"quality services" at "just, reasonable, and affordable" rates, and rates and services that are comparable to those provided in urban areas.[7]

Professor Lehman's paper shows that a forward-looking cost standard falls short of the balance that must be considered in choosing a mechanism. That balance includes promoting investment, reducing costs and protecting the principle of comparable rates and services. The use of embedded costs to establish rural ILEC is a better alternative than a forward-looking cost standard for many reasons. Among them are the following: (1) it would be extremely challenging to validate a forward-looking cost model;[8] (2) forward-looking costs have inherent estimation problems for rural carrier;[9] and (3) the theoretical incentive producing advantages of a forward-looking cost standard are unlikely to materialize in practice.[10] These reasons are explored in detail in Attachment A. Professor Lehman's analysis demonstrates that a shift to a forward-looking standard is unlikely to achieve the efficiency goals envisioned by proponents who argue that the standard should be applied to rural telephone companies for that reason.

The decision on a mechanism for the future funding of support for rural telephone companies is part of a wider set of issues, including reform of intercarrier compensation, the President's pronouncement that broadband should be made available to all Americans by 2007 and the possibility that the next Congress will begin deliberations over a rewrite of the Communications Act. The Joint Board should retain the existing mechanism in the interest of preserving a stable environment for investment in high-cost rural areas and the maintenance of universal service in the interim during which fundamental changes in the industry could occur. It is counter-productive to engage huge resources in a debate over embedded cost versus forward-looking economic costs during a time when other changes may make this debate a moot issue.

[7] Section 254(b).
[8] Lehman at 9.
[9] Lehman at 10-17.
[10] Lehman at 17-20.

III. THE COMMISSION SHOULD CONTINUE TO USE THE STATUTORY DEFINITION OF A RURAL TELEPHONE COMPANY TO DETERMINE WHICH CARRIERS ARE RURAL CARRIERS FOR PURPOSES OF HIGH-COST SUPPORT

The Joint Board is concerned that use of the "rural telephone company" definition in subsection 3(37)(D) of the Act results in anomalies for purposes of determining rural high-cost universal service support for some companies.[11] 47 U.S.C.§ 153(37)(D) defines a rural telephone company as "a local exchange carrier operating entity to the extent that such entity… [h]as less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996." This subsection expands the absolute 100,000-access line size limit in subsection 3(37)(C). The Board points out that 40 companies serving study areas with more than 100,000 access lines, including one company serving over 2 million access lines, self-certified as rural carriers under this subsection.[12] Reliance on subsection 3(37)(D) and other subsections of the statutory definition permits companies with more than 100,000 lines to receive support on the basis of embedded costs instead of the proxy model mechanism used to determine the costs of non-rural companies.

The Joint Board should not recommend the use of size alone as a determinant of what type of company is eligible to receive support using the "rural" mechanism. The higher costs to serve customers in rural telephone company service areas is a driving force that makes it imperative to retain a mechanism that will maintain universal service in high-cost, rural and insular areas in a manner consistent with the principles in Section 254(b) of the Act. The Federal-State Joint Board that recommended a modified embedded cost mechanism for rural telephone companies relied on the Rural Task Force recommendation. The RTF recommendation was based on a plethora of complex and interrelated factors. A primary factor behind the RTF recommendation was the marked differences between the service areas of rural

[11] Public Notice ¶ 9.
[12] Public Notice at n.25.

telephone companies as defined by the Act and areas served by non-rural companies.[13] The RTF analyzed and documented these differences in "White Paper 2: The Rural Difference."[14] The RTF concluded and the Joint Board agreed that the modified embedded cost mechanism would preserve a "predictable level" of support that would contribute to the stability of rural carriers and provide incentives to continue to invest. It also concluded that the mechanism would be "sufficient" for these carriers.[15]

The 2000 Joint Board had the benefit of lengthy deliberations and a substantial evidentiary record to support its recommendation. The Joint Board in this proceeding should not change the mechanism for "rural telephone companies" unless and until it has done a similar analysis and is able to conclude that use of the proxy model or some other forward looking economic cost mechanism will comport with the principles of Section 254(b) and be otherwise consistent with the goal of administrative efficiency. The Board has no basis upon which to base such a conclusion. In fact, as shown in Section II above, there is no indication that the use of forward looking economic costs for any subset of rural telephone companies will accomplish the goals of Section 254.

IV. THE CURRENT RURAL ILEC USF EMBEDDED COST METHODOLOGY SHOULD BE RETAINED BEYOND THE FIVE-YEAR RTF PLAN

The Joint Board seeks comment on whether the current embedded cost methodology for determining rural ILEC support should be retained beyond the five years of the RTF plan or whether some changes should be made with respect to how embedded costs are determined, assuming that the Commission ultimately concludes that rural carriers should continue to receive

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13 See, *In the Matter of Federal-State Joint Board on Universal Service*, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, 16 FCC Rcd 6165, 6174-6177. (2000)(RTF Joint Board Recommendation)

14 Available at www.wutc.wa.gov/rtf/rtfpub.nsf

15 (RTF Joint Board Recommendation) 16 FCC Rcd 6165, 6158.

support based on embedded costs.[16] NTCA recommends that the current rural USF embedded cost methodology should continue beyond the five-year RTF plan for purposes of determining rural ILEC high-cost support.[17]

Congress is expected to consider a Communications Act rewrite, which may provide the FCC with clear direction on how to regulate the universal service support mechanisms in the future. Congress may very well require the Commission to apply the current embedded cost methodology to rural ILECs. If the Commission changes the methodology before Congress acts, the Commission may be required to reverse itself in the near future. The Joint Board should therefore recommend that the Commission refrain from changing the current rural ILEC high-cost USF methodology at this time.

The current high-cost universal service rules permit rural carriers to recover their investment in the total network facilities needed to provide comparable rates and services to customers living in rural and high-cost areas. High-cost support reflects the legitimate costs of rural carriers serving their entire rural study areas, an obligation that is imposed on these companies as carriers of last resort. Without support for the entire cost of the network, many consumers living in rural high-cost regions of the United States would not have access to affordable and comparable telecommunications services. To avoid such an outcome, the Joint Board should recommend that the Commission retain the current rural methodology for determining high-cost support for rural ILECs beyond the five-year RTF plan.

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[16] Public Notice, ¶33.

[17] For purposes of CETC support, NTCA recommends that the Commission eliminate the identical support rule and require CETCs to base their support on their own costs. See discussion of NTCA's recommendation on the basis of CETC support in Section V. For purposes of safety valve support, NTCA also recommends a modification to the rule for first year investments in acquired exchanges. See NTCA's recommendation concerning the safety valve rule in Section X.

V. THE COMMISSION SHOULD ELIMINATE THE IDENTICAL SUPPORT RULES AND REQUIRE CETCs TO BASE THEIR SUPPORT ON THEIR OWN COSTS

The Joint Board seeks comment on whether CETCs should receive support based on their own costs, the incumbent's costs, the lesser of its own or the incumbent's costs, or some other estimate of costs.[18] NTCA urges the Joint Board to recommend that the Commission eliminate the identical support rule and require CETCs to base their support on their own costs.

The Commission's "identical support rule" provides that CETCs receive the same per line support as ILECs, based on the ILEC's costs.[19] Section 254(e) requires that support be used "only for the provision, maintenance, and upgrading of the facilities and services for which the support is intended" and "[a]ny such support should be explicit and sufficient to achieve the purposes of this section."[20] Congress thus contemplated restrictions on both the use and level of support. The United States Court of Appeals for the 5th Circuit has already warned: "excessive funding may itself violate the sufficiency requirement of the Act."[21] By failing to establish a relationship between a CETC's costs and the support the CETC receives, the existing rule distorts and ignores the notion of "sufficiency." The rule advantages classes of carriers, in particular wireless CETCs, by allowing them to receive support unrelated to their costs. It is also not competitively neutral because wireless CETCs are held to a lower service standard than the incumbents. The rules have undeniably become the basis for unfair competition in high-cost rural service areas and are the critical instrument used by wireless CETCs for gaming universal service support dollars that have no relationship to their cost of providing service.

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[18] Public Notice, ¶ 36.
[19] 47 C.F.R. § 54.307.
[20] 47 U.S.C. § 254(e).
[21] *Texas Office of Public Utility Counsel v. FCC,* 183 F.3d at 412 (U.S.C.A. 5th Cir. 1999)

Moreover, the identical support rule has provided an irresistible temptation for CETCs. Even if the management of a CETC knows that their costs are low enough to compete effectively without the additional support, they are compelled by their fiduciary duty to seek CETC designation so as to maximize profits and avoid lost opportunities to obtain support. The Commission has become increasingly concerned about the impact on the USF due to the rapid growth in high-cost support distributed to CETCs. As the chart below based on USAC's quarterly fund size projections demonstrates, universal service support to CETCs based on the identical support rule is the driving force behind existing and future growth in the high-cost universal service fund.[22]

	ANNUALIZED ($Millions)			
	2nd Quarter 2003 Support	4th Quarter 2003 Support	3rd Quarter 2004 Support	Change 2Q 2003 - 3Q 2004
CETC HC Support				
Non-Rural	$ 43.0	$ 54.4	$ 104.8	144%
Rural	$ 104.4	$ 197.4	$ 432.1	314%
Total	$ 147.4	$ 251.7	$ 536.9	264%
ILEC HC Support				
Non-rural	$ 741.9	$ 743.8	$ 723.4	-2%
Rural	$ 2,409.0	$ 2,436.1	$ 2,525.2	5%
Total	$ 3,150.9	$ 3,179.9	$ 3,248.6	3%
All Companies				
Non-rural	$ 784.9	$ 798.1	$ 828.2	6%
Rural	$ 2,513.4	$ 2,633.5	$ 2,957.3	18%
Total	$ 3,298.3	$ 3,431.6	$ 3,785.5	15%

Furthermore, wireless CETCs are exempt from rate and state entry regulation; this allows them to avoid the substantial costs associated with carrier-of-last-resort obligations, service quality requirements, cost-studies, rate cases, accounting obligations, separations requirements, audit reviews, and other state and federal regulatory mandates.[23] As Commissioner Abernathy

[22] Universal Service Administrative Company (USAC).

[23] Wireless CETCs neither provide the same quality of local service or interstate access services to consumers. They do not use the same type of facilities to provide the services or incur the same costs for providing the services as rural ILECs. Wireless CETCs do not have high-cost loops and do not provide ubiquitous local service. They also

identifies:

> Requiring incumbent LECs, but no one else, to comply with costly regulations and to open their books to competitors raises obvious questions of competitive neutrality.[24]

This regulatory disparity coupled with application of the identical support rule, provides for an artificial inducement for competition that unjustifiably favors wireless CETCs.

The current rules have created an insidious incentive for wireless carriers to seek CETC status in high-cost areas where they already provide wireless service. Wireless carriers have every incentive to seek CETC status because they can obtain high-cost support for existing ILEC subscribers without ever demonstrating their costs and determining whether wireless costs are high enough to warrant high-cost support. When a wireless CETC receives universal service support under these circumstances it is a pure windfall in direct violation of Section 254(e). The Joint Board therefore should recommend to the Commission that it eliminate the identical support rule and require all CETCs to base their support on their own costs before the burden on the universal service fund becomes too great.

VI. SIMILAR COST ALLOCATION RULES SHOULD APPLY TO WIRELESS CETCs

The Joint Board seeks comment on whether the FCC's cost allocation rules should be extended to CETCs seeking universal service support.[25] Not all rural ILEC costs are included in the calculation of universal service support. While it may be inappropriate to use the same cost allocation rules for CETCs, the rules should provide for a proper allocation of CETC costs by

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do not have the interstate access costs relevant to the Interstate Common Line Support (ICLS) mechanism because they have no wireline local loops on which the ICLS mechanism is based. And, unlike rural ILECs, wireless CETCs do not offer equal access to all long distance carriers and hence wireless CETC costs for providing access to a single long distance carrier are likely substantially lower than the rural ILEC's costs.

[24] Separate Statement of Commission Kathleen Q. Abernathy, Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286, Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, and 80-286, FCC 01-305, In the Matter of 2000 Biennial Regulatory Review – Comprehensive Review of Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2, Amendments to the Uniform System of Accounts for Interconnection, Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Local Competition and Broadband Reporting, p. 2 (rel. November 5, 2001).

[25] Public Notice, ¶ 37.

means of estimates or proxy-like mechanisms. This will ensure that support is not excessive and used for the purposes intended as required by Section 254(e). Section 254(k) further requires the Commission, with respect to interstate services, and the States, with respect to intrastate services, to "establish cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than their reasonable share of the joint and common costs of facilities used to provide those services." Applying similar cost allocation rules to wireless CETC costs will ensure that wireless CETCs cannot use USF support to cross-subsidize services and unfairly compete in the communications services marketplace.

VII. THE COMMISSION SHOULD CONTINUE TO CALCULATE RURAL ILEC SUPPORT BASED ON THE CARRIER'S STUDY AREA AVERAGE COSTS

The Joint Board seeks comment on whether it should continue to calculate high-cost universal service support for rural carriers based on the individual carrier's study area average costs.[26] The current use of study area average costs in the high-cost universal service rules have allowed rural carriers to recover their investment in the total network facilities needed to provide comparable rates and services to customers living in rural and high-cost areas. Basing support on some other basis, such as the non-rural statewide average costs, will neither ensure that rural carriers receive sufficient support nor that rural consumers receive comparable rates and services as compared to urban consumers. Most rural carriers serve a single study area in a state and these study areas are generally the highest cost areas in the state. Rural carriers do not have the benefit of averaging the cost of serving these areas with lower costs in another part of the state. Statewide averaging in these cases would most likely result in insufficient support. The use of statewide average costs in the non-rural universal service mechanisms has resulted in distortions, which are likely to carry over if applied in the rural context. As a result of statewide averaging of non-rural support, only eight states receive non-rural high-cost support. This has led Qwest to

[26] Public Notice, ¶ 38.

seek legislative relief in states where it is not receiving non-rural high-cost support and this issue will likely be part of any rewrite of the Act. Without rural carrier support based on study area average costs, many consumers living in rural high-cost regions of the United States may not have access to affordable and comparable telecommunications services. To avoid such an outcome, the Joint Board should recommend that the Commission continue to use study area average costs in the current rural methodology for determining high-cost support for rural ILECs.

VIII. SUPPORT FOR CORPORATE OPERATIONS EXPENSES IS CRITICAL FOR SMALL, RURAL CARRIERS

The Joint Board seeks comment on whether the corporate operations expense adjustment in the high-cost loop support mechanism remains appropriate or needs to be adjusted.[27] NTCA urges the Joint Board to recommend retaining the corporate operations expense adjustment in its current form. The corporate operations expense adjustment is critical for rural telephone companies and should remain as part of the rural high-cost loop support mechanism.

Corporate operations expenses are not trivial, and cannot be overlooked or ignored. For small, rural carriers particularly, such expenses can provide a substantial obstacle to being able to provide service to their customers. In a recent white paper on the universal service needs of rural service providers,[28] economist Dale Lehman, Ph.D. finds that while corporate operating expenses are highly variable, this variability is primarily a function of company size. When examining several years of cost data (to minimize the effect of such infrequent but significant events as rate cases) and analyzing the data by aggregating at the holding company, rather than the study area level, Lehman finds that only 12% of the variability in corporate operations expenses is not explained by company size.[29] This casts significant doubt upon previous claims that small

[27] Public Notice, ¶ 40.
[28] Dale Lehman, "False Premises, False Conclusions: A Response to an Attack on Universal Service," August, 2004. Available online at NTCA's website: www.ntca.org.
[29] *Id.* at 14.

company inefficiencies were a significant cause of variability in corporate operating expenses.[30] Since such support provides small carriers with an important and predictable means of recouping these necessary costs, it should be retained as part of the rural ILEC high-cost loop support mechanism.

IX. SWITCHING COSTS ARE HIGHER FOR SMALL COMPANIES THAN FOR LARGER COMPANIES; HENCE, LOCAL SWITCHING SUPPORT (LSS) FOR SMALL COMPANIES MUST BE RETAINED

The Joint Board seeks comment on whether there is a continued need to provide the local switching support (LSS) to carriers serving 50,000 or fewer lines.[31] NTCA urges the Joint Board to recommend the Commission continue to provide LSS to small rural telephone companies. Switching costs disproportionately impact small companies. According to data submitted last year, the weighted mean per loop switching investment in 2002 for rural companies with less than 500 loops was more than triple that of those rural companies with between 50,000 and 100,000 loops. Similarly, rural companies with between 500 and 1,000 loops faced per loop switching costs that were 2⅓ times greater than those rural companies with between 50,000 and 100,000 loops. LSS helps offset the harmful impact of higher local switching costs on small rural providers. In the interest of the upholding the goals of universal service, it is crucial that LSS continue to be made available to eligible carriers.

X. THE COMMISSION SHOULD MODIFY ITS SAFETY VALVE RULES TO PROVIDE CARRIERS SUPPORT BASED ON THEIR FIRST YEAR INVESTMENT IN ACQUIRED EXCHANGES

On July 5, 2001, NTCA filed a petition for Reconsideration and Clarification concerning the Commission's safety valve rule.[32] In its petition, NTCA demonstrated the safety valve rule's

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[30] See, "Lost in Translation: How Rate of Return Regulation Transformed the Universal Service Fund for Customers into Corporate Welfare for the RLECs," Economics and Technology, Inc., February 2004.
[31] Public Notice, ¶ 42, *See also* 47 C.F.R. § 54.301.
[32] *See,* NTCA's Petition for Reconsideration and Clarification, CC Docket No. 96-45 (filed July 5, 2001), and NTCA's Reply to Oppositions to its Petition for Reconsideration, CC Docket No. 96-45 (filed August 10. 2001).

adverse impact on consumers and rural carriers.[33] Specifically, the rule provides that rural ILECs receive no safety valve support for first year investments in newly acquired exchanges.[34] This is a major problem for rural ILECs because the first year of operating an acquired exchange is the most important year for both the rural carrier and rural consumers eager for new and improved communications services. Traditionally, the first year is a time of great investment by the acquiring carrier in an effort to upgrade old and inefficient equipment. It is also the most significant year for the carrier to establish a good working relationship with consumers living in the newly acquired exchange. It is the first time that consumers in acquired exchanges are introduced to their new telecommunications services provider and form their opinion of new provider's quality service and customer responsiveness. Without sufficient universal service support to assist rural carriers during the first year to implement necessary upgrades to acquired exchanges, the acquiring carrier's first year of operations can result in continued poor service and consumer disdain.

The Rural Task Force stated that "any additional universal service support should be driven by post-transaction investments made to enhance the infrastructure of and improve the

[33] The current acquired exchange support rules require a carrier that acquires exchanges from an unaffiliated carrier to receive universal service support for those acquired exchanges at the same per-line support levels for which the exchanges were eligible for support prior to the acquisition. This is known as the "parent trap rule" 47 C.F.R. §54.305(a). If a rural carrier seeks more support for an acquired exchange than available under the parent trap rule it can apply for additional support under the safety valve rule. 47 C.F.R. §54.305(b). The safety valve rule requires that a rural carrier's index year expense adjustment for an acquired exchange equal the carrier's high-cost loop expense adjustment of the exchange calculated at the end of the carrier's first year of operating the acquired exchange. 47 C.F.R. §54.305(c). At the end of each subsequent year, a loop cost expense adjustment for the acquired exchange is calculated and compared to the index year expense adjustment. 47 C.F.R. §54.305(c). The rule also provides that up to 50 percent of any positive difference between the subsequent year loop cost expense adjustment and the index year expense adjustment is eligible safety valve support in a subsequent year. 47 C.F.R. §54.305(d). The rule then caps the total amount of safety valve support available to all ETCs in a given year to five percent of the rural high-cost universal service fund. 47 C.F.R. §54.305(e). The problem with the parent trap rule and the safety valve rule is that neither rule allows for any additional support based on the acquiring carrier's first year investments in the acquired exchange.

[34] *Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for the Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* Federal Register, Vol. 66, No. 108, Final Rules, 47 C.F.R. 54.305(c) (June 5, 2001).

service in these exchanges."[35] This is consistent with Section 254(b)(3) which states that "[c]onsumers in all regions of the Nation ...should have access to telecommunications ...services ...that are reasonably comparable to those services provided in urban areas ..." Denying safety valve support for acquired exchanges for an entire year amounts to an arbitrage application of Section 254(b)(3) to those consumers who happen to receive service from an acquiring carrier. This is unfair to both consumers and the rural carriers trying to provide improved services in these rural high-cost areas.

As NTCA previously recommended in its petition, as a matter of sound public policy, the purchasing carrier should be encouraged to begin necessary investment immediately upon acquisition of an exchange. Amending the safety valve rules to permit safety valve support in the first year of acquisition will allow for this to happen and ensure that the objective of Section 254(b)(3) is met during the first year of acquisition. This can accomplish by defining the index year expense adjustment as the selling carrier's expense adjustment at the time of the sale of the exchange.[36] The acquiring carrier's first year expense adjustment for the acquired exchange should then be compared to the seller's index year expense adjustment to determine any positive difference eligible for safety valve support in the acquiring carriers first year of operations. NTCA's proposed modification to the rule will provide the appropriate incentive for rural carriers to invest in acquired exchanges and assist the Commission in its efforts to ensure rural consumers receives comparable rates and services as required by the Act. NTCA urges the Joint Board to recommend that the Commission adopt NTCA's proposed modification to the safety valve rule.

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[35] *See Rural Task Force Recommendation,* p. 30, Letter from William R. Gillis, Chair, Rural Task Force, to Magalie Roman Salas, FCC, dated September 29, 2000 (Rural Task Force Recommendation).
[36] Non–rural carriers are required to report their study area average costs to NECA on an annual basis in accordance with sections 36.611 and 36.612 of the FCC's rules. These costs are then used in determining the national average loop cost. *In the Matter of the Federal-State Joint Board on Universal Service; Muti-Association Group (MAG) Plan for the Regulation of Interstate Services of Non-Price cap Incumbent Local Exchange Carriers and Interexchange Carriers,* CC Dockets 96-45 and 00-256, FCC 01-157, ¶103, footnote 274.

XI. THE JOINT BOARD SHOULD RECOMMEND TO THE COMMISSION THAT IT WILL NEED TO EXPAND THE BASE OF USF CONTRIBUTORS TO INCLUDE CABLE, WIRELESS AND SATELLITE PROVIDERS OF BROADBAND INTERNET ACCESS AND FACILITIES-BASED AND NON-FACILITIES-BASED VoIP AND IP-ENABLED SERVICE PROVIDERS

The Commission has the authority to expand the number and types of contributors to the fund to ensure "sufficient" support to achieve the goals of the Act. NTCA believes that the time is ripe for the Commission to expand the list of contributors to include both facilities-based and non-facilities-based voice over Internet protocol (VoIP) and IP-enabled service providers and all cable, wireless and satellite providers of broadband Internet access and other providers that connect to or benefit from connection to the public, regardless of the classification of the service as an information service, telecommunications service or private carriage service. The universe of "telecommunications carriers" and providers of telecommunications and the share of new providers' markets have expanded far beyond the boundaries that existed when the Commission first identified contributors to universal service. It is time for the Joint Board to recommend to the Commission that it expand the base of contributors to ensure contributions on an equitable and nondiscriminatory basis pursuant to Section 254(d).

XII. CONCLUSION

For the above reasons, NTCA urges the Joint Board to recommend that the Commission:

(1) refrain from applying a forward looking economic cost model for determining high-cost universal service support for rural ILECs;

(2) retain the current definition of a "rural telephone company" for purposes of receiving rural high-cost universal service support;

(3) allow the current rural ILEC USF embedded cost methodology to continue beyond the five-year RTF plan for purposes of determining rural ILEC high-cost support;

(4) eliminate the identical support rule and require CETC support to be based on their own costs, not the ILEC's costs;

(5) apply similar cost allocation rules to wireless CETCs;

(6) continue to calculate rural ILEC support based on the individual carrier's study area average costs;

(7) retain the current corporate operations expense adjustment;

(8) continue to provide local switching support to rural telephone companies;

(9) modify the safety valve rule to provide carrier support for their first year investment in acquired exchanges; and

(10) expand the base of USF contributors to include all cable, wireless and satellite providers of broadband Internet access and facilities-based and non-facilities-based VoIP and IP-enabled service providers.

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NATIONAL TELECOMMUNICATIONS
COOPERATIVE ASSOCIATION

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October 15, 2004

CERTIFICATE OF SERVICE

I, Gail C. Malloy, certify that a copy of the foregoing Initial Comments of the National Telecommunications Cooperative Association in CC Docket No. 96-45, FCC 04J-2 was served on this 15th day of October 2004 by first-class, U.S. Mail, postage prepaid, to the following persons:

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